

STATEMENT OF

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on the

“Financial Services Regulatory Relief Act of 2002”

before the

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT**

of the

**COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES**

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Mr. Chairman, Representative Waters, and Members of the Subcommittee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on proposed legislation to provide regulatory burden relief. The FDIC shares the Subcommittee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves.

In my testimony today, I will highlight the FDIC's efforts to reduce regulatory burden in areas where statutory change may not be necessary. Next, I will address the specific provisions in the proposed legislation that the FDIC requested to improve our performance. Finally, I will suggest additional provisions for inclusion in the proposed legislation.

FDIC EFFORTS TO RELIEVE REGULATORY BURDEN

At a leadership conference of our senior officials in early February, FDIC Chairman Don Powell unveiled his vision for the Corporation. The Chairman's approach will more actively integrate management objectives into our three strategic lines of operation—insurance, supervision, and receivership management. His theme is more business-oriented and is explicitly designed to incorporate concepts of regulatory burden reduction, following closely along with the lines of today's Subcommittee hearing.

The FDIC is committed to updating its corporate culture. We are building a culture which encourages employees to recognize new ideas as opportunities — not as

threats which so often happens in a conservative bureaucratic structure. This changing culture will be beneficial as the FDIC looks for better ways to communicate with the banking industry and consumers and to monitor and supervise the industry in a more efficient manner.

The FDIC is engaged in a number of initiatives to address the issue of regulatory burden. Some of the initiatives were recently completed while others are ongoing and will yield future improvements.

Regulatory Burden Reduction Working Group

Chairman Powell recently formed a regulatory burden task force within the FDIC to study ways to reduce the regulatory burden that may result from the agency's activities. While mindful of the FDIC's statutory and regulatory obligations, the task force will review the FDIC's operating principles, processes, and practices; study ways to make the FDIC more sensitive to the burden issue; and make recommendations to the Chairman on burden reduction. For example, one of the group's tasks will be to develop a better definition of "burden" from the industry's point of view and to consider means of obtaining input from the industry quickly and efficiently on a continuing basis. The task force's activities will be ongoing and we expect this group to make an initial report to Chairman Powell by the end of April.

Regulatory Relief through Streamlining Examination Processes and Procedures

The FDIC recently initiated a comprehensive review of our internal processes and operating procedures related to the supervision of state-chartered nonmember banks. In

this Process Redesign effort, working groups reviewed: Examinations and Applications; Policy; Training and Administration; Technology; and Infrastructure. The FDIC also met with each of the other bank regulatory agencies to identify “best practices.” The goal of this review is to strengthen our efforts to allocate resources to the areas that present the greatest risk to the insurance funds, such as problem banks, larger financial institutions, technological change, high risk/subprime lending, internal control procedures, and fraud detection.

By streamlining, standardizing, and consolidating more of our processes, we have improved the FDIC’s operating efficiencies and have also significantly aided in the regulatory relief effort. This extensive process has already produced the following recommendations and suggestions which have been implemented:

- *Revised Report of Examination:* The FDIC changed its report of examination format to make it more user-friendly by placing regulatory comments—a key item for bank management’s attention—at the beginning of the report. We also consolidated several supporting pages to reduce redundancies and make findings more understandable. The revised format should generate fewer questions and make the significant issues clearer to the bank’s board of directors.
- *Establishment of Applications Subject Matter Experts:* In their regular course of business, bankers are required to file various applications for regulatory approval, such as establishing a new bank, merging with another institution, changing

control or ownership, or opening new branch offices. The FDIC has designated Applications Subject Matter Experts to serve as a centralized resource for bankers, particularly those who have more complex applications or those who file infrequently. This program has been well-received by the industry and has resulted in greater consistency and more timely processing of bank applications.

- *Increased Banker's Outreach Efforts:* New technologies, product innovations, and recent statutory changes highlighted the need for ongoing communication with supervised banks during the interval between safety and soundness examinations. We now contact each bank between examinations to discuss issues such as new business activities, local economic conditions, changes in bank management or key personnel and to solicit any concerns the bank may have about the FDIC's supervisory program. The information shared during this process helps the FDIC better understand individual bank issues which leads to a more focused and efficient examination process.
- *Establishment of a Cadre of Information Technology Examiners:* Technology continues to transform banking, leading to new ways of doing business and potentially new risks. For example, many financial institutions, both large and small, run transactional web sites, having adopted Internet banking at a rapid rate. In order to keep pace with this rapidly changing field, the FDIC selected 25 of our best technology examiners to examine the large data centers and software vendors. Bankers will benefit from a single point of contact at the FDIC for each

technology service provider, and these uniquely qualified individuals will be a valuable resource on emerging technology trends.

The FDIC is also working on an initiative for historically sound well-run institutions. We are reviewing the examination process to achieve maximum efficiencies in the examination of the best-rated banks with less than \$250 million in assets. Our performance goal is to reduce total examination hours in these institutions by 20 percent, while maintaining the quality and integrity of the examination process. We are developing guidelines to assist our examiners in determining which examination procedures can be streamlined, or even entirely eliminated, depending on the bank's risk profile and quality of management. There will be an emphasis on using the bank's loan review and other internal grading systems. Similar programs are being developed for information technology and trust examinations.

The FDIC has had preliminary discussions with the other federal banking agencies regarding streamlined examination programs that the agencies have or may be considering. In addition, we will discuss our new programs that are under development with the Conference of State Bank Supervisors to see if some of the efficiencies can be transferred to state exams as well.

Along with these changes to the safety and soundness examination process, we also are revising our compliance examination approach to place a greater emphasis on an institution's administration of its compliance responsibilities. While we currently

consider an institution's compliance program, the compliance examination process has been heavily slanted toward transaction testing. We draw conclusions about the institution's compliance program and its management from the results of this testing.

Our revised approach will change the process so that examiners begin by evaluating—in depth—an institution's compliance management. Examiners will assess, for example, how a bank keeps abreast of regulatory requirements, and how it incorporates these requirements into specific business processes such as mortgage loan applications. The examiners will particularly consider the bank's internal monitoring and audits of regulatory compliance, since a strong internal audit program may significantly reduce the risk that regulatory violations are going undetected and uncorrected. Based on their review of the compliance program, examiners will determine where there may be significant risk of regulatory violations and appropriately tailor their transactional testing.

In addition, we are developing enhanced guidance for compliance examiners that will strengthen their ability to not only evaluate an institution's compliance program and management, but also to provide practical suggestions about how to rectify any weaknesses that may be found. For example, if examiners find that an institution has a training program, but the training has not been effective, they will suggest steps the institution might take to either modify the training or follow up so that employees are prepared to carry out their responsibilities correctly. The compliance examination report provided to the institution also will be revised to concentrate on the examiner's

assessment of the bank's administration of its compliance responsibilities, suggestions for how to strengthen it, and other significant regulatory matters.

The revised compliance examination approach will be implemented in early 2003. We expect that, over time, the number of hours spent examining institutions with strong compliance programs or functions will be reduced. This will allow more examiner attention to be focused on those institutions with weak compliance functions and a greater risk of violating consumer protection laws or regulations.

Interagency Coordination

In addition to our internal efforts, the FDIC continues to work with the other banking regulators in implementing more efficient regulations and processes. A recent example of our interagency efforts is the new "Interagency Charter and Federal Deposit Insurance Application" — a coordinated effort between the FDIC, the OCC, and the OTS. The new form will eliminate duplicative information requests by consolidating into one uniform document the different reporting requirements of the three regulatory agencies. The agencies already have four other common forms to promote uniformity: Interagency Notice of Change in Control, Interagency Notice of Change in Director and Senior Executive Officer, Interagency Biographical and Financial Report, and Interagency Bank Merger Act Application.

Another interagency effort aimed at burden reduction was also announced this week. The federal bank regulatory agencies and the Conference of State Bank

Supervisors have developed standardized requests for electronic loan information. Regulators use this information primarily to conduct community and mid-size bank safety and soundness examinations. The information is currently provided in various formats, making the collection a time-consuming and costly task. The new standard, which is voluntary on the part of institutions, will improve the efficiency of the examination process and reduce the burden on banks, service providers, and vendors.

Along with the initiatives discussed above, the FDIC supports statutory changes to reduce regulatory burden in a number of areas which are in the draft bill. Let me turn to these specific provisions of the proposed legislation.

“FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002”

The FDIC’s staff has worked closely with the Subcommittee in developing several of the provisions contained in the proposed legislation. These provisions promote the Subcommittee’s goal of burden reduction by making the FDIC’s operations more efficient and more effective.

Clarification of Section 8(g) Prohibition Authority

Section 8(g) of the Federal Deposit Insurance Act (FDI Act) provides the appropriate Federal banking agency with the authority to suspend or prohibit individuals charged with certain crimes from participation in the affairs of the depository institution with which they are affiliated. The FDIC supports the provision in the proposal that clarifies that the agency may suspend or prohibit those individuals from participation in

the affairs of any depository institution and not solely the insured depository institution with which the institution affiliated party is or was associated. The provision will make clear that a Federal banking agency may use the section 8(g) remedy even where the institution that the individuals were associated ceases to exist.

Judicial Review of Conservatorship and Receivership Appointments

The FDIC supports the amendments in the proposed legislation that would specify the time period during which the appointment, in certain circumstances, of the FDIC as conservator or receiver of a failed insured depository institution could be challenged. These amendments would provide greater consistency in the Federal law governing how much time an insured depository institution has to challenge the appointment of a receiver. Moreover, they would provide greater certainty to the receiver's activities and those doing business with the receiver.

Currently, some provisions of Federal law specify a 30-day period for challenges after appointment. In contrast, other provisions of the FDI Act, which govern appointment of a conservator or receiver by the appropriate Federal banking agencies for a State institution under prompt corrective action provisions and the FDIC's appointment of itself as conservator or receiver for an insured depository institution to reduce risk to the deposit insurance fund respectively, are silent on the limitations period for challenges to those appointments. At least one court has previously held that the Administrative Procedure Act applied because the National Bank Receivership Act was silent regarding the time period for challenging such an appointment. The court held that the national

bank had six years from the date of appointment to challenge the action. The proposed legislation would remedy the silence in the National Bank Receivership Act and in the Federal Deposit Insurance Act consistent with the parallel provisions in section 5 of the Home Owners' Loan Act and another appointments provision of the Federal Deposit Insurance Act.

Recordkeeping Amendment

The FDIC supports the provision to modify the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed. Currently, the statute requires the FDIC to preserve all records of a failed institution for six years from the date of its appointment as receiver, regardless of the age of the records. After the end of six years, the FDIC can destroy any records that it determines to be unnecessary, unless directed not to do so by a court or a government agency or prohibited by law. Consequently, the FDIC must preserve for six years very old records that have no value to the FDIC or to any pending litigation.

The proposed provision would allow the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or a government agency or prohibited by law. This change would benefit the FDIC or acquirers of failed institutions by reducing the storage costs for these outdated records.

Preservation of Records by Optical Imaging and Other Means

The FDIC supports the provision in the proposed legislation to permit the FDIC to rely on records preserved electronically, such as optically imaged or computer scanned images, as well as the “preservation of records by photography” as the statute currently provides.

Under present law, the FDIC is permitted to use “permanent photographic records” in place of original records for all purposes, including introduction of documents into evidence in State and Federal court. The substance of the statute has been unchanged since 1950. Because of the advent of electronic information systems and imaging technologies that do not have any photographic basis, this amendment would significantly aid the FDIC in preservation of documents by newer methods. In addition, it can be expected that the technology in this area will continue to develop. This amendment is intended to provide the FDIC with the flexibility to rely on appropriate new technology, while retaining the requirement that our Board of Directors prescribe the manner of the preservation of records to ensure their reliability, regardless of the technology used.

The FDIC also supports a number of provisions that were requested by our fellow regulators and included in the proposal. In particular, we support provisions in the bill that streamline merger application requirements; that grant federal banking agencies the authority to enforce conditions imposed in certain written agreements relating to additional capital contributions; and that permit bank examiners to receive credit cards

from any insured depository institution as long as the cards are issued under the same terms and conditions as cards generally offered to the public. Moreover, the bill makes a number of changes to update or conform existing statutes that we believe are quite useful.

Finally, I would like to comment on a provision in the proposal that eases restrictions on interstate branching and mergers. Under section 18(c)(1) of the FDI Act, FDIC approval is necessary whenever an FDIC-insured institution merges with or assumes deposit liabilities of any uninsured bank or institution. We are pleased that the Subcommittee remedied a concern that we had in the language as originally drafted. Under the proposed bill, approvals for interstate mergers or consolidations are governed according to the current section 44 of the FDI Act. Section 44 of the FDI Act authorizes "the responsible agency" to approve interstate insured bank mergers. "The responsible agency" generally means the appropriate federal banking agency of the resulting institution. Without the provision that the Subcommittee added to clarify the meaning of "responsible agency" the proposed language could have been read to mean that the FDIC does not approve interstate mergers between insured banks and noninsured banks. We appreciate the Subcommittee's cooperation in alleviating this concern.

OTHER ISSUES FOR INCLUSION IN THE BILL

The FDIC recommends that the Subcommittee include four additional regulatory relief items in the bill. The appendix to my testimony contains the relevant legislative language.

Authority to Enforce Conditions on the Approval of Deposit Insurance

The FDIC supports an amendment to Section 8 of the FDI Act to provide each of the other three appropriate Federal banking agencies with express statutory authority to take enforcement action against the banks they supervise based upon a violation of a condition imposed in writing in connection with the approval of an institution's application for deposit insurance.

The FDIC frequently imposes written conditions when approving deposit insurance to a de novo bank or thrift pursuant to section 5 of the FDI Act (application for deposit insurance). Because of a drafting anomaly under current law, the other three appropriate Federal banking agencies cannot enforce violations of deposit insurance conditions by their supervised institutions. Currently, our only recourse—for institutions that we do not serve as primary regulator—is to commence deposit insurance termination proceedings. This provision would provide express enforcement authority for the involved institution's appropriate Federal banking agency.

Deposit Insurance Related to the Optional Conversion of Federal Savings Associations

Under a provision adopted in the Gramm-Leach-Bliley Act (Section 739), Section 5(i)(5) of the Home Owners' Loan Act permits Federal savings associations with branches in one or more states to undergo a conversion into one or more national or state banks. Such conversions require the approval of the OCC and/or the appropriate state authorities. However, Section 739 does not specifically mention either deposit insurance or the FDIC.

The FDIC supports an amendment to Section 739 clarifying that conversions under that section, which result in more than one bank, would continue to require deposit insurance applications from the resulting institutions, as well as review and approval by the appropriate Federal banking agency. A one-to-one conversion does not change the risk to the deposit insurance funds because it involves one institution simply changing charters. However, a “breakup conversion” presents a potential increase in risk to the insurance funds because two or more institutions are created with risk profiles that differ from the original institution.

Bank Merger Act and Bank Holding Company Act

The FDIC supports amendments to the Bank Merger Act and Bank Holding Company Act that would require consideration of the potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation/acquisition. As presently written, these laws do not require that any specific consideration be given to a transaction’s possible impact on the deposit insurance funds. The omission is noteworthy and potentially damaging to the financial viability of the funds.

Language specifying consideration of risks to the insurance funds already exists for consideration of other transactions. For example, regarding change in control of insured banks, the FDI Act provides authority to the appropriate federal banking agency to disapprove any proposed acquisition if the agency determines that the proposed

transaction would result in an adverse effect on the Bank Insurance Fund or the Savings Association Insurance Fund.

In addition, Section 207 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) amended Section 6 of the FDI Act to include a new factor—“the risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund”—that must be considered in granting deposit insurance. Additional parallels can also be found in sections 24 and 28 of the FDI Act.

Given the potential insurance risks inherent in transactions involving large diversified financial services organizations, the addition of an "adverse effect on the deposit insurance funds" assessment factor as a requirement under the Bank Merger Act and Bank Holding Company Act would seem warranted. As with the other factors, each of the agencies would be required to make a separate “adverse effect on the deposit insurance funds” evaluation during its review of the proposed transaction. The intent would be to ensure that the financial integrity of the BIF and the SAIF are prime considerations in any proposed combination. As indicated, there is precedent in other bank application reviews and we believe a compelling case can be made for its inclusion in both the Bank Merger Act and the Bank Holding Company Act.

Pre-receivership Liens for Failure to Pay Property Taxes

Three Circuit Courts have construed section 15(b) of the FDI Act *not* to require the extinction of pre-receivership liens securing penalties for the nonpayment of property taxes on real property that the FDIC later acquires as receiver. The FDIC supports language which would make clear that such liens *are* extinguished when the property is acquired by the federal receiver. Allowing the liens to continue compels payment of penalties for which the FDIC is not liable and is thus inconsistent with the purposes of section 15(b).

CONCLUSION

Thank you for the opportunity to present the FDIC's views on these issues. The FDIC supports the Subcommittee's continued efforts to reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection. We continually strive for more efficiency in the regulatory process and are pleased to work with the Subcommittee in accomplishing this goal.

APPENDIX

LEGISLATIVE LANGUAGE FOR FDIC RECOMMENDATIONS

Authority to Enforce Conditions on the Approval of Deposit Insurance

Section 8 of the Federal Deposit Insurance Act (12 U.S.C. § 1818) is amended –

(a) in subsection (b)(1) in the first sentence, by striking “any condition imposed in writing by the agency” and inserting “any condition imposed in writing by a Federal banking agency”;

(b) in subsection (e)(1)(A)(i)(III), by striking “any condition imposed in writing by the appropriate Federal banking agency” and inserting “any condition imposed in writing by a Federal banking agency”; and

(c) in subsection (i)(2)(A)(iii), by striking “any condition imposed in writing by the appropriate Federal banking agency” and inserting “any condition imposed in writing by a Federal banking agency”.

Clarification of Certain Application Requirements for Optional Conversion of Federal Savings Associations

(a) Paragraph 5 of section 5(i) of the Home Owners’ Loan Act (12 U.S.C. 1464(i)(5)) is amended to read as follows --

(5) CONVERSION TO NATIONAL OR STATE BANK. –

(A) IN GENERAL. – Any Federal savings association chartered and in operation before the date of the enactment of the Gramm-Leach-Bliley Act, with branches in operation before such date of enactment in 1 or more States, may convert, at its option, with the approval of the Comptroller of the Currency for each national bank, and with the approval of the appropriate State bank supervisor and the appropriate Federal banking agency for each State bank, into 1 or more national or State banks, each of which may encompass 1 or more of the branches of the Federal savings association in operation before such date of enactment in 1 or more States, but only if each resulting national or State bank (i) will meet all financial, management, and capital requirements applicable to the resulting national or State bank, and (ii) if more than 1 national or State bank results from a conversion under this subparagraph, has received approval from the Federal Deposit Insurance Corporation under section 5(a) of the Federal Deposit Insurance Act. No application under section 18(c) of the Federal

Deposit Insurance Act shall be required for a conversion under this subparagraph.

(B) DEFINITIONS. – For purposes of this paragraph, the terms “State bank” and “State bank supervisor” have the meanings given those terms in section 3 of the Federal Deposit Insurance Act.”.

(b) Section 4(c) of the Federal Deposit Insurance Act (12 U.S.C. § 1814(c)) is amended –

(1) after “Subject to section 5(d)”, by inserting “of this Act and section 5(i)(5) of the Home Owners’ Loan Act”; and

(2) in paragraph (2), after “insured State” by inserting “or Federal”.

Bank Merger Act and Bank Holding Company Act Amendments Risk to Insurance Funds

Bank Merger Act Amendment

Paragraph (5) of subsection (c) of section 18 of the Federal Deposit Insurance Act (12 U.S.C. § 1828(c)(5)) is amended -

by amending the last sentence of paragraph (5), by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Bank Holding Company Act Amendment

Paragraph (2) of subsection (c) of section 3 of the Bank Holding Company Act (12 U.S.C. § 1842(c)(2)) is amended -

by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Pre-receivership Liens for Failure to Pay Property Taxes

Subsection (b) of section 15 of the Federal Deposit Insurance Act (12 U.S.C. § 1825) is amended –

(1) by striking “When acting as a receiver” and inserting “In its capacity as receiver” ; and

(2) by amending paragraph (3) to read as follows:

“(3) The Corporation shall not pay, be subject to, or be liable for, directly or indirectly, any amounts in the nature of penalties or fines, including those arising from the failure of any person to pay any real property, personal property, probate, or recording tax or any recording or filing fees. Any lien that shall have attached to property before such property becomes property of the Corporation is extinguished to the extent it secures any amounts in the nature of penalties or fines.”.